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Ethical Problems and Responsibilities of the Tax Attorney

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Ethical Problems and Responsibilities of the Tax Attorney.

The attorney of today and for the foreseeable future must of necessity have some knowledge of tax law. Every client that walks into his office has some contact with the Internal Revenue Service. When dealing with these problems is the attorney required to use a different set of standards than normally used in his practice of law?

A striking difference between the general practice of law and tax practices is that the tax lawyer has the same adversary in every matter. His opponent is always his Government, and his dealings are mainly with its agents and lawyers. Thus, the attorney may have "dual responsibilities" both to his client and to his Government.

1 "... in this world nothing is certain but death and taxes." Franklin, Letter (in French) to Leroy, (1789).
The answers to the problems are by no means clear cut. There is no line of division between black and white; rather, there is a large area of gray.

History shows that the tax collector was originally considered an intruder. In the past the courts have promulgated this attitude by placing the burden of proving tax liability squarely on the government and allowing the citizen to use any type of device to avoid the tax so long as he adhered to the mere form of legality, thus staying within the letter of the law. Justice Holmes had this concept in mind when he said, "When the law draws a line, a case is on one side of it or the other and if on the safe side it is none the worse legally that a party had availed himself to the full of what the law permits." On another occasion Justice Holmes added the thought, "The fact that it is desired to evade the law, as it is called, is immaterial, because the very meaning of a line in the law is that you intentionally may go as close to it as you can if you do not pass it .... It is a matter of proximity and degree as to which minds will differ ...."

This is not the attitude of the courts today. You may still go as close to the line as possible so long as you don't cross it, but as a practical matter the burden of proof is on the taxpayer to show that he didn't cross the line. Since the enactment of the income tax laws, taxes are no longer looked upon as mere nuisances, the avoidance of which would give one little or no advantage over others. Today, tax evasion gives greater economic advantage to the evader over honest persons who faithfully and conscientiously pay their taxes than ever before.

Lawyers will generally agree that to perpetrate an obvious fraud is neither legally nor morally justifiable. It is the moral duty of the tax lawyer to exercise due diligence so that he does not advise a plan of "tax evasion" under the guise of "tax avoidance". The dis-

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2 United States v. Ishan, 17 Wall. 496 (U. S. 1873).
4 Superior Oil Co. v. Mississippi, 280 U. S. 390, 395 (1930).
5 The lawyer "must not be guilty of any fraudulent acts, and he must be free from any unlawful conspiracy with either his client, the judge, or any other person, which might have a tendency either to frustrate the administration of justice or to obtain for his client something to which he is not justly and fairly entitled." Langen v. Brokowski, 188 Wis. 277, 302, 206 N.W. 181, 190-191 (1925).
tinction between the two terms is fundamental and presents no serious problem of definition. "Avoidance" connotes a course of action whereby a person may legally avoid a particular taxable event by so arranging his affairs as to avoid the occurrence of that event. "Evasion" refers to a course of action whereby a person avoids paying tax on a taxable event either by an obviously illegal method, or, more often, by arranging his affairs so that in form no taxable event occurs, while in substance the apparent arranging of affairs has not affected the occurrence of the taxable event.

It is obvious that "avoidance" is both legally and morally justifiable while "evasion" is not. The lawyer, however, is presented with the practical difficulty of determining whether the plan he suggests is actually one of legal tax avoidance or merely a legal label attached to a tax evasion scheme. The problem is sometimes difficult to answer from the authorities available. For an attorney to exercise less than due care and diligence before advising a course of action is a breach of his duty, both moral and professional, to his client.

Tax attorneys know very well that tax avoidance is "in the nature of mortals." The courts have recognized that the practice is almost universal. There is nothing reprehensible or illicit in attempts to avoid by legal means some part of the burden of taxation, or in an honest effort to reduce taxes to the minimum required by law.

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6 "There is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands; taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant." Commissioner v. Newman, 159 F.2d 848, 850-851 (2d Cir. 1947) (L. Hand, J., dissenting).


9 "An attorney at law is an officer of the court. The nature of his obligations is both public and private. His public duty consists in his obligation to aid the administration of justice; his private duty, to faithfully, honestly and conscientiously represent the interest of his client. In every case that comes to him in his professional capacity, he must determine wherein lies his obligations to his client, and to discharge this duty properly requires the exercise of a keen discrimination, and wherever the duties to his client conflict with those he owes to the public as an officer of the court in the administration of justice, the former must yield to the latter." Langen v. Borkowski, supra note 5 at 301, 206 N.W. at 190.

10 Wiggins v. Commissioner, 46 F.2d 743 (1st Cir. 1931).


12 Iowa Bridge Co. v. Commissioner, 39 F.2d 777 (8th Cir. 1930).

13 Sawtell v. Commissioner, 82 F.2d 221 (1st Cir. 1936).

The taxpayer is not required to choose the one of two available courses to the same final position which will produce the greater tax liability. He is always entitled to seek "such shelter as the law offers in an effort to escape" or reduce the effect of taxation. Of course he must always decide whether the devise he uses is allowable by statute. If high taxes, like high waters, make an old path unusable, the taxpayer is entitled to choose any new path his attorney determines will reduce his taxes. "To say that the old path must be blindly followed, that bypaths or new paths may not be laid out with proper strides within legal bounds, goes too far." Different tax results may be derived from the same transaction by the use of different methods. Taxpayers are plainly entitled to select the method which results in lower tax liability.

It is sufficient that the tax attorney's advice puts his client on the safe side of the line drawn by the statute. In fact, it is his duty to show the client how to avail himself to the fullest of what the law permits. "He is not the keeper of the Congressional conscience."

The tax attorney should realize that on the other side are the Government and the community of which he is a member. More sources than one have made him aware of this double responsibility even though the public interest side of his obligations has not been widely stated. While in ordinary litigation the bar has been told that it is entitled and perhaps required to take a firm, unyielding attitude with respect to revelation of harmful evidence, there may be times for less strictly partisan behavior when tax disputes are handled. This line of thought is emphasized by the knowledge that the official enforcement personnel could not possibly make a burden-

17 Superior Oil Co. v. Mississippi, supra note 4.
19 See, Tarleau, Ethical Problems of Tax Practitioners, 8 Tax L. Rev. 1, 10-14 (1952).
21 See, Williston, Life and Law 271-272 (1940). (refraining from correcting judge's statement of fact, although Mr. Williston did and his opponents did not know the truth).
some and complex tax system work without a high degree of voluntary compliance and cooperation from taxpayers and their advisers.

The Canons of Professional Ethics are directed principally toward the lawyers' duties in connection with judicial controls. The specialized problems of taxation have to do with administrative controls, relationships and procedure. Also, tax attorneys in their relationship with the Internal Revenue Service are subject to the Code of Conduct embodied in Circular 230. With respect to professional ethics, this Circular places two sets of responsibilities upon the attorney. First, it incorporates by reference the standards of the Canons of Professional Ethics, and secondly, it details its own special provisions of the duties that an enrolled Treasury attorney owes when dealing with revenue matters.

Thus, we can see that in matters of taxation the lawyer is doubly charged, owing fidelity both to his client and to the Treasury. He should, for example, "... exercise due diligence in preparing ... returns ... and other papers relating to Internal Revenue Service matters," and he should not "... unreasonably delay the prompt disposition of any matter before the Internal Revenue Service" by dragging his feet or imposing frivolous obstacles. Further, he is charged with the duty, despite the unpleasant nature of such action, to give on due request "... any information he may have concerning violations of the regulations ... and to testify thereto in any proceeding ... for the disbarment or suspension of an enrolled attorney or agent, unless such information is privileged.

The question is whether the standards applicable to the conduct of attorneys representing clients before the Internal Revenue Service vary from those which are applicable to attorneys in the general practice of law. Do they place upon the tax attorney a responsibility on certain occasions to put the interest of the Service in a position above the interest of their clients?

Generally speaking, the ethical problems facing a tax attorney in dealing with the Service are the same as those of any lawyer dealing with an adversary. However, the attorney dealing with the Service is

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28 Treas. Reg. § 10.22 (b) (1958).
also charged with the additional responsibility imposed by the Department of whose Bar he is an enrolled member.\textsuperscript{29} Thus, when the Service asks for data and information they are entitled to such information if it is pertinent to the issue\textsuperscript{30} and the lawyer assumes the responsibility for the accuracy of the information furnished.\textsuperscript{31}

In arguing the legal merits of the case, the attorney may project the most favorable light for his client upon the facts. He is not bound to support interpretations of the facts which might help the Government, but he is duty-bound not to conceal facts which are material to the issue which is being considered, while in the private litigation an attorney is generally free to furnish his opposition facts, or to refuse them, depending upon the tactics of the case.\textsuperscript{32}

The general principle is clear that the lawyer practicing before the Internal Revenue Service has an obligation to engage in open-handed dealings with the representatives of the Service and to avoid anything suggestive of concealment or sharp practice. Of course, “the obligation to avoid concealment or subterfuge does not go so far as to require counsel to furnish the Government with the ammunition to defeat a taxpayer’s valid claims.”\textsuperscript{33}

Answers to some questions may be found in illustrative examples. Mr. Hellerstein proposed\textsuperscript{34} a question involving the settlor of a trust, the income of which his tax lawyer was fearful might be taxable to him under the Clifford doctrine.\textsuperscript{35} However, the issue was in doubt. He also submitted a question involving interest payments on notes which might be attached under the so-called “thin incorporation” doctrine.\textsuperscript{36} In both these cases it was clear that the Internal Revenue Service would decide the issue adversely to the client if the facts were brought to the Service’s attention, although it was not clear what the results would be if the questions went to court. Should the tax attorney insist upon a full disclosure, advising the client to put in his return all the facts relating to the Clifford question? Should he

\textsuperscript{29} Treas. Reg. § 10.2 (1958).
\textsuperscript{30} Treas. Reg. § 10.22 (a) (1958).
\textsuperscript{31} Treas. Reg. § 10.24 (1958).
\textsuperscript{32} WILLLSTON, op. cit. supra note 21.
\textsuperscript{33} Tarleau, op. cit. supra note 19, at 12.
\textsuperscript{34} Hellerstein, Ethical Problems of Tax Practitioners, 8 Tax L. Rev. 1, 8 (1959).
\textsuperscript{35} See Helvering v. Clifford, 309 U. S. 331 (1940); see also Eisenstein, The Clifford Regulations and the Heavenly City of Legislative Intention, 2 Tax L. Rev. 327 (1947).
advise the corporation to call attention in its return to the circumstances of "thin incorporation," so the issue would not be overlooked by the Service, or should the attorney decide these questions in the clients' favor and advise him not to display them in the return?

Mr. Hellerstein stated that most tax attorneys would not advise disclosure, but would go along, hoping "with some anxiety, but with no feeling of guilt, that the revenue agent would miss the item." "It is the ethics of the profession," Mr. Hellerstein concluded, that "the tax practitioner does not regard it as his duty to recommend full and fair disclosure of the facts as to items questionable in law."37

Other situations involving tax returns of a client merit consideration. Suppose it is clear to the lawyer that a certain item of income should be included in the return, but the client refuses to include it. If the lawyer is doing no more than advising, with the actual making of the return done by someone else, there is respectable authority38 for the position that giving the disapproving advice is enough. The lawyer need not refuse to further advise the client; still less is he obliged or even free to make disclosure to the Internal Revenue Service.39 If, however, the lawyer is to prepare the return, sign it, and thus take responsibility for the correctness of its content, he should not participate.40 Suppose, however, that the lawyer, in good faith, has prepared the return, signed it, and filed it with the Service, and then discovers that either by mistake or intentionally his client has omitted an item. Assume further that upon this discovery the client refuses to file an amended return. What are the lawyer's duties now? Does the client-attorney confidential communication privilege stand or is the attorney under a duty to withdraw from the case or to break silence and inform the Service? Mr. Tarleau41 expressed doubt as to the existence of a client-attorney privilege when the attorney discovers that the client has furnished misinformation for inclusion in the return. Mr. Darrell42 would see to it that the information was brought to the attention of the revenue agent if the audit took place in his office, and he would try to get the client to do so if the audit took place elsewhere. However, Mr. Drinker43

37 Hellerstein, op. cit. supra note 34.
39 Ibid.; Drinker, Legal Ethics 138 n. 31 (1953); Canon 37, A.B.A. Canons of Professional Ethics (1937).
40 This is very clear under Treas. Reg. § 10.51(b)(3) (1958).
41 Tarleau, op. cit. supra note 19, at 13-14.
42 Darrell, op. cit. supra note 38, at 20-21.
43 Drinker, op. cit. supra note 39.
states that the attorney may not inform the Service of the failure of his client to disclose the item. Would withdrawal by the attorney be enough, without disclosure of the truth, or must he reveal the information to the Service? Opinion 15544 states that there are cases when communication is not privileged for reasons of public policy. In these cases an attorney can not remain silent. "When the communication by the client to his attorney is in respect to the future commission of an unlawful act or to a continuing wrong, the communication is not privileged. One who is actually engaged in committing a wrong can have no privileged witnesses, and public policy forbids that an attorney should assist in the commission thereof, or permit the relation of attorney and client to conceal the wrongdoing," Justice Cardoza has stated45 that "A client who consults an attorney for advice that will serve him in the commission of a fraud will have no help from the law. He must let the truth be told." Cardoza also said that once the relation was abused by the client in the determination of the court, then the client-attorney relationship vanished. "To drive the privilege away there must be 'something to give colour to the charge'; there must be 'prima facie evidence that it has some foundation of fact.' When that evidence is supplied the seal of secrecy is broken."46 Thus, under the circumstances stated it would seem that the attorney-client relationship dissolved and the attorney would have a duty to report the former client. However, Circular 230 does not go this far, at least, not directly. It states that the attorney who knows of an error or omission from a return must advise the client of the error or omission,47 but it does not state that he must advise the Service of the omission; however, the attorney may be disbarred or suspended from practice before the Internal Revenue Service for "... knowingly giving false or misleading information relative to a matter pending before the Service ..."48 or "... preparing a false financial statement ... or certifying the correctness of such false statement, knowing the same to be false ... ."49

The question then arises, would the failure of the attorney to inform the service of the omission after the return was filed but before

45 Clark v. United States, 289 U. S. 1, 15 (1932).
46 Ibid.
audit come within the provisions above? If the attorney remains silent during the audit when he has signed the return would this be certifying the correctness of such false statement and knowingly giving false or misleading information to the Service? If there were to be no audit it would seem that the attorney's only duty would be to inform his client of his omission; however, where an audit is to be performed, the above questions present a very serious problem for which there is no clear-cut answer.

Another problem the tax attorney faces, one not easily answered and on which the authorities are not in agreement, is the attorney's relationship with the accounting profession in working with clients' tax problems. To what extent may the attorney and accountant work together? May they be partners, may they split fees?

In a recent New York case\textsuperscript{50} it was held that an attorney and an accountant could work together on a client's tax problems and could split a contingent fee, so long as the fee provided for the accountant was to be for accounting services rendered by him, and the fee for the lawyer for legal services that he performed. The New York court said that this arrangement came close to the ideal arrangement contemplated by the New York State Bar Association and the New York State Society of Certified Public Accountants acting jointly in 1962.\textsuperscript{51} In their joint statement the two associations stated that there were many areas in the tax field where the two professions were interrelated and overlapped. They declared that it was in the public interest for them to work together and that a client represented by an attorney-accountant team before the Internal Revenue Service was most effectively represented.

Judge Burke in his dissenting opinion stated that such a partnership was a violation of the Canons of Professional Ethics governing the independence required of a lawyer in his dealings with his client. Canon 34\textsuperscript{52} is very explicit in its prohibition of fee splitting except with another attorney, based upon a division of responsibility. Canon 33\textsuperscript{53} prohibits partnerships between members of the bar and members of other professions where any part of the partnership's


\textsuperscript{52} Canon 34, A.B.A. Canons of Professional Ethics (1937).

\textsuperscript{53} Canon 33, A.B.A. Canons of Professional Ethics (1937).
employment consists of the practice of law. The Committee on Professional Ethics of the American Bar Association has ruled that a partnership between a lawyer and a layman accountant to specialize in income tax work and related accounting is permissible only if the lawyer, “completely disassociates himself from any practice or holding out that would indicate that he is a member of the bar or in any way engaged in practice as a lawyer.” Canon 33 applies in the Committees’ opinion, “to one who holds himself out as a lawyer and at the same time engages in a type of activity open to laymen which serves as a natural feeder to his law practice.” Similarly, Canon 35 provides,

“The professional service of a lawyer should not be controlled or exploited by any lay agency, personal or corporate, which intervenes between client and lawyer. A lawyer’s responsibilities and qualifications are individual. He should avoid all relations which direct the performance of his duties by or in the interest of such intermediary. A lawyer’s relation to his client should be personal, and the responsibility should be direct to the client . . . .”

With respect to this Canon the Committee on Professional Ethics has ruled that “A lawyer may properly be employed by a firm of accountants on a salaried basis, to advise the accounting firm, but such employment may under no circumstances be used to enable the accounting firm to render legal advice or legal services to its clients.”

Obviously the attorney dealing with a tax matter does have special responsibilities that he does not have in private litigation. Not only does he have a duty to his client but he also owes an obligation to his Government and he must be cautious of his relationship with lay professions that are closely related to tax problems.

There are no easy answers to the questions presented here. Each case must be measured upon its own merit and the attorney using the Code of Professional Ethics and Circular 230 as a guide must

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57 Canon 15, A.B.A. Canon of Professional Ethics (1908).
still decide for himself the honorable and ethical path to follow. The requirements placed upon him are not always clear. It is hoped that in the near future the Internal Revenue Service will attempt to clarify some of these areas of dual responsibility. Until this is done the attorney has the almost impossible task of applying the high ethical standards of his profession in his clients interest and yet tempering this duty with the advice of Holmes in another context, that "Men must turn square corners when they deal with the Government." 59

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